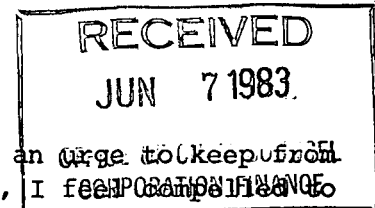


June 6, 1983

MEMORANDUM TO: Members of the SEC Advisory Committee on Tender Offers

FROM: Alan R. Gruber

RE: COMMENTS



After having struggled valiantly but unsuccessfully with an ~~urge to keep up from~~ adding to the paperwork burden we've been laboring under, ~~I feel compelled to~~ add a few comments on the drafts and comments already in circulation. My comments herein are addressed primarily to the May 25 draft report which was sent to all Members of the Committee by Mr. Lipton with his memorandum of May 26, and to Professor Easterbrook's memorandum of May 31 (the substance of which was endorsed by Assistant Attorney General Baxter on June 2).

The May 25 draft report contains many valuable suggestions. Any such Committee effort necessarily involves decisions on specific details with which one or more Members of the Committee may not be in total agreement. For my part, I am not inclined to endorse the unconstrained continuation of partial, two-tier, and two-step tender offers (seeing some virtue in the British system, but believing that constraints short of the British system might present a satisfactory compromise) or of "Pac-Man" defense, for example.

Further, I believe that 30 days is not "an eternity" (per Professor Easterbrook), and that extensions up to 45 or 60 days for a counter-bidder would be very appropriate. The time pressures for counter-bidders in the proposed new system would be too severe, especially if the counter-bidder is to use securities instead of or together with cash. The initial bidder already has the advantage of speed and surprise. The only way in which potential targets will be able to blunt the added advantage which would be given in the new system to potential bidders would be to maintain standing defensive measures and stand-by arrangements with potential white knights, which would involve expenditure of corporate time and money which could obviously be devoted to more constructive purposes.

I also believe that the suggestion of advisory votes adds little or nothing to stockholders' existing ability to register their opposition in a far more significant fashion--i.e., by electing new Directors. --I believe that the existing disclosure system has already proven its value by generating high levels of embarrassment where there have been excesses; these exemplary excesses have already, I am sure, had an impact on Boards of Directors generally in their consideration of possible future actions. As Mr. Lipton has pointed out, advisory votes would tend to undermine the business judgment rule and could result in a major (and, in my belief, un-needed) change in our corporate governance system.

I have a more basic reservation with the May 25 report, with (most especially) Professor Easterbrook's May 31 report and with what I perceive to be the general thrust of the Committee's deliberations. There seems to be an underlying assumption that tender offers are good and that their success should be facilitated by giving bidders a greater advantage than they now have.\* I believe that tender offers are

\* Mr. Icahn's comments about our favoring targets are principally in the context of creeping tenders, which is another subject.

not necessarily bad and that they should continue to be permitted, with appropriate regulation. In this connection, the comments sent to the Committee by the American Council of Life Insurance (letters of April 12 and, especially, May 11) are worthy of consideration with regard to the question of the extent to which the tender offer system should be permitted to override the jurisdiction of state insurance commissioners (see especially the first full paragraph on page 10 of the letter of May 11).

To the extent that our Committee's conclusions are based on the accepting the notion that tender offers have positive economic consequences for bidder shareholders (as regards share price) as well as for target shareholders, I must take sharp exception.

While tender offers clearly have positive market price consequences for target shareholders, it is not at all clear that the consequences are positive for bidder shareholders or for "all" shareholders. The report of the Economics Subcommittee (April 11) talks of bidder share appreciation of 4%. However, the Jensen & Ruback paper (MERC 83-08) on which the conclusions are based is not nearly so simple or clear. First, the studies summarized by Jensen & Ruback focus on near term (one month or less following offer announcement) impact; second, they are dated (only one of the six studies summarized goes through 1980, while the others are through 1978 at the latest); and third, studies summarizing bidder results one year later show indications of systematic reductions in bidder stock prices--which the authors call "unsettling because they are inconsistent with market efficiency". Jensen & Ruback further state that "explanation of these post-event negative abnormal returns is currently an unsettled issue".

I believe that these studies of bidder stock performance, conducted by study of general market residuals, is an example of answering the wrong question because it is answerable rather than recognizing that the right question may not be answerable. A key issue is just what is the relevant sample against which bidders should be compared. It clearly isn't the total universe of all companies; i.e., the companies which make tender offers are in a select group which have activist managements, resources (including the availability of credit), etc., and the unanswerable question is whether the shareholders of the bidders might have done as well or better if the tender offers had not been made.

The economic results of some of the recent larger (post-1980) tenders would surely have a negative impact on the Jensen & Ruback conclusions (which appear, incidentally, not to be weighted by size of tender). The Economics Subcommittee has found virtue in the fact that shortly after the duPont-Conoco transaction the loss to duPont shareholders was smaller than the gain to Conoco shareholders, reflecting "a real gain...to the economy as a whole". One might comment that the near term performance of duPont shares, close to the time of the transaction, reflected mystery about Seagram's intentions as well as the possible over-enthusiasm on the oil outlook. Viewing the transaction today, after a much longer time period than 20 days, the duPont shareholders have not fared well on a relative basis compared with the shareholders of, say, Union Carbide or Dow, and their total relative capital loss is now comparable to the premium received earlier by Conoco shareholders. Similarly, the shareholders of Fluor have fared much less well than the shareholders of, say, Morrison-Knudsen, which didn't buy a St. Joe Minerals. Was the acquisition of Marathon by U. S. Steel really an example of "shifting resources to higher-valued uses on a large scale"? For the duPont shareholder, the question is whether the

shareholder would have been better off at various times in the future if, instead of buying Conoco, duPont had done nothing, invested in new plants or research programs, bought a company in another field or tendered for some of its own shares. This question cannot be answered.

I have no objection if one feels comfortable believing in the notion that stockholders of bidders gain from tender offers. To me it is like Creationism; believe in it if you wish, but don't claim that it is based on meaningful scientific evidence. It just isn't so.

Unfortunately, the exaltation of the tender offer as a device to be fostered for its own sake would only add to the heavy emphasis already placed on short-term earnings and market performance by the investment community, by management compensation systems, etc., without regard to whether the methods used to achieve those short-term results are beneficial either to a particular potential target or to the economy as a whole.

ARG:soc

cc: Linda Quinn, Esq.  
David B. H. Martin, Jr., Esq. ✓